

**Opportunities Exist to Expand
the TeleFile Program**

March 2003

Reference Number: 2003-40-092

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 31, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Opportunities Exist to Expand the
TeleFile Program (Audit # 200240061)

This report presents the results of our review to determine if opportunities exist for the Internal Revenue Service (IRS) to expand its TeleFile Program. The TeleFile Program enables taxpayers to file their United States (U.S.) Individual Income Tax Returns (Form 1040EZ) by telephone. Taxpayers call the IRS using a toll-free telephone number and, via automated prompts, enter their tax return information using their telephone keypads. The TeleFile Program offers those taxpayers eligible to participate the ability to file their tax returns quickly, accurately, and absolutely free of charge. In addition, the IRS saves substantially on the cost to process¹ TeleFile tax returns (\$2.84 per tax return), when compared with the cost to process paper-filed tax returns (\$3.92 per tax return).

The IRS, in a move towards a paperless tax filing system, initiated the TeleFile Program on a limited basis in 1992. During the 1996 Filing Season,² the TeleFile Program was offered on a nationwide basis to taxpayers who filed their tax returns using the single status. During the 1997 Filing Season, the Program was further expanded to include those taxpayers who filed their tax returns with the married filing jointly status.

Opportunities exist for the IRS to expand its TeleFile Program to provide more taxpayers with the option of filing via telephone. The number of taxpayers who use the TeleFile system each year decreased from the 1998 to 2002 Filing Seasons. Since the expansion of the TeleFile Program in 1997, the IRS has not identified any additional opportunities to expand taxpayer TeleFile Program eligibility. For example, taxpayers who file a Form 1040EZ but are first-time tax return filers, or who move subsequent to

¹ This cost comparison is for Fiscal Year 2000, as these are the most current data available from the IRS for processing costs associated with paper-filed tax returns.

² The filing season is the period from January through mid-April when most individual income tax returns are filed.

receiving a TeleFile tax package, are not eligible to use the TeleFile system. Data processing limitations affect the IRS' ability to validate the legitimacy of first-time tax return filers and update the addresses of taxpayers who move subsequent to receiving a TeleFile tax package.

The IRS' reluctance to expand the TeleFile Program was based primarily on management's incorrect perception that the processing costs for TeleFile tax returns significantly exceed the processing costs for paper-filed and other electronically filed (*e-filed*) tax returns. Management also believed that the use of a telephone to file tax returns is considered obsolete because of the widespread use of computers and the Internet.

To provide measurable benefits to both the taxpayer and the IRS, and to enable the IRS to continue to move towards its goal of having 80 percent of all tax returns *e-filed* by 2007, we recommended that the Director, Electronic Tax Administration, develop a strategy outlining steps to be taken to offer the TeleFile Program to those taxpayers who file a Form 1040EZ and are currently ineligible to use the TeleFile system. Further, a 2001 study by the U.S. Department of Commerce³ identified that nearly half of the taxpayers with incomes less than \$35,000 (many of whom are among the current TeleFile Program market segment) do not have access to the Internet. Therefore, the TeleFile Program is an excellent way for the IRS to promote free *e-filing* to a segment of taxpayers who may be seeking an alternative to using the Internet.

Management's Response: IRS management agreed with our recommendation and plans to establish a task force to look at opportunities for expanding TeleFile to include taxpayers who move and first-time filers. IRS management disagreed, however, with our reported benefits, stating that we presented cost comparisons that may not be consistent, and that the costing analyses compare dissimilar cost categories from separate sources. While the IRS acknowledged that it provided us with the cost information, it stressed that the bases for each category are different enough that conclusions should not be drawn from direct comparisons. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: We agree with management's assertion that the processing cost comparisons are based on costing estimates from different IRS sources and include different costing categories. However, as we indicate in the report, these costing figures were provided by the IRS and were the best and most reliable figures available, which is confirmed in management's response. The costs were discussed at length with IRS executives who oversee the TeleFile Program as well as the processing of paper tax returns. The final costing figures were agreed to be reasonable based on the information the IRS had available. In addition, the costing categories provide different results because the processing of paper versus the processing of electronic tax returns includes different components (i.e., paper return processing includes a number of manual operations which are not necessary for TeleFile processing). As a result of IRS executive management's assertion that these are the best and most reliable costing

³ *A Nation On-Line: How Americans Are Expanding Their Use of the Internet*, dated February 2002.

estimates, we used them to support our position that increased taxpayer participation in the TeleFile Program will result in processing cost savings to the IRS.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

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Opportunities Exist to Expand the TeleFile Program

Background

The TeleFile Program enables taxpayers to file their United States (U.S.) Individual Income Tax Returns (Form 1040EZ) by telephone. Taxpayers call the Internal Revenue Service (IRS) using a toll-free telephone number and, via automated prompts, enter their tax return information using their telephone keypads. The TeleFile Program offers those taxpayers eligible to participate the ability to file their tax returns quickly, accurately, and absolutely free of charge. In addition, the IRS saves substantially on the cost to process¹ TeleFile tax returns (\$2.84 per tax return), when compared with the cost to process paper-filed tax returns (\$3.92 per tax return).

The IRS, in a move towards a paperless tax filing system, initiated the TeleFile Program on a limited basis in 1992. During the 1996 Filing Season,² the TeleFile Program was offered on a nationwide basis to taxpayers who filed their tax returns using the single status. During the 1997 Filing Season, the Program was further expanded to include those taxpayers who filed their tax returns with the married filing jointly status.

Each year, before the start of a tax return filing season, the IRS analyzes taxpayer information from previous year tax return filings and pre-qualifies those taxpayers who have met the IRS' eligibility requirements to participate in the TeleFile Program. The IRS' analysis of prior year return data is performed primarily to identify taxpayers who filed using a Form 1040EZ.

Once the IRS identifies the taxpayers eligible to participate, it mails a TeleFile tax package to these taxpayers at the start of the tax return filing season (January). The TeleFile tax package contains all of the necessary instructions to file via telephone, along with the Customer Service Number (CSN) assigned by the IRS to be used to confirm the identity of the taxpayer in the TeleFile system.

¹ The cost comparison is for Fiscal Year 2000, as these are the most current data available from the IRS for processing costs associated with paper-filed tax returns.

² The filing season is the period from January through mid-April when most individual income tax returns are filed.

Opportunities Exist to Expand the TeleFile Program

However, since the IRS' determination of eligibility is based on previous year tax return filing information, taxpayers who receive a TeleFile tax package must still meet the following criteria to use the TeleFile system:

- Reside at the address printed on their TeleFile tax package.
- Have total taxable income of \$57,700 or less (if filing as single) or total taxable income of \$63,850 or less (if filing as married filing jointly) from wages, salaries, tips, and interest (which must be less than \$400).
- Have access to a touch-tone telephone.
- File as single or married filing jointly and have no dependents.

If all the conditions above are met, the taxpayer can elect to participate in the TeleFile Program. However, because eligibility is based on analysis of prior year tax data, a large number of taxpayers may receive a TeleFile tax package and no longer be eligible to participate. Ineligibility could be based on the taxpayer filing a different tax form, income in excess of the ceilings, claims for dependents, etc. For example, for Tax Year (TY) 2000, over 5.8 million taxpayers received the TeleFile tax package but were not eligible. These account for nearly 38 percent of the TeleFile tax packages mailed for TY 2000.³

Taxpayers who elect to use the TeleFile system contact the IRS via the toll-free telephone number provided. Upon connection, the TeleFile system prompts the taxpayer to enter his or her Social Security Number (SSN), the 5-digit CSN, and the taxpayer's date of birth. The IRS uses this information to verify the identity of the taxpayer. If the validity process is successful, subsequent automated prompts then guide the taxpayer through the needed entries to complete the filing of the tax return.

This audit was performed at the IRS' National Headquarters in the Wage and Investment Division's offices of Electronic Tax Administration (ETA); Submission Processing; and Strategy and Finance, Research, during the period July through November 2002. The audit was conducted in

³ The IRS' "Project 1.01 Profile Report Individual ETA Marketing Research for Processing Year 2001," dated April 19, 2002.

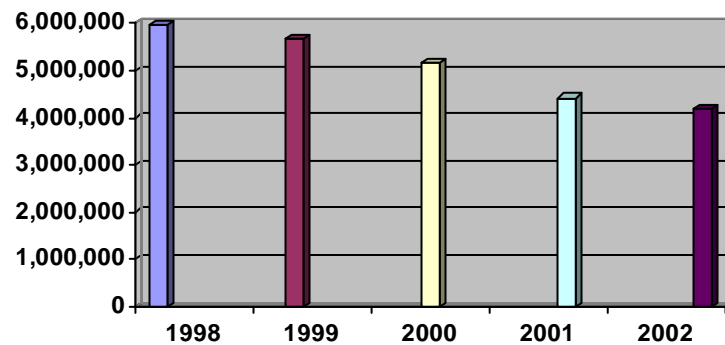
Opportunities Exist to Expand the TeleFile Program

Expanding the TeleFile Program Could Benefit Nearly Six Million Taxpayers

accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Opportunities exist for the IRS to expand its TeleFile Program to provide more taxpayers with the option of filing via telephone. The number of taxpayers who use the TeleFile system each year decreased from the 1998 to 2002 Filing Seasons (see Figure 1).

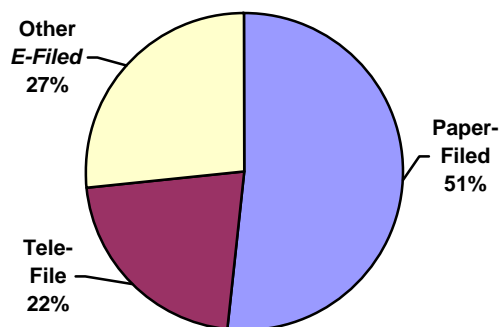
Figure 1
**Number of Taxpayers Who Use the
TeleFile System Declined**



Source: IRS Office of ETA.

Since expansion of the TeleFile Program in 1997, the IRS has not identified any additional opportunities for expansion. For TY 2001, 19.3 million taxpayers filed a Form 1040EZ tax return; however, only 4.1 million taxpayers elected to use the TeleFile system (see Figure 2).

Figure 2
Analysis of Number of Form 1040EZ Filings



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the IRS' TY 2001 data.

Opportunities Exist to Expand the TeleFile Program

There are two groups of taxpayers who filed Form 1040EZ tax returns but are ineligible to use the TeleFile system. They may provide the IRS with opportunities to expand the Program. These two groups include:

- First-time tax return filers.
- Taxpayers who move subsequent to receiving a TeleFile tax package.

Data processing limitations affect the IRS' ability to validate the legitimacy of first-time tax return filers and update the addresses of taxpayers who move subsequent to receiving a TeleFile tax package.

First-time tax return filers are not eligible to use the TeleFile system

First-time tax return filers are not eligible to use the TeleFile system, as the IRS does not have the necessary data to independently verify the legitimacy of these taxpayers. Specifically, since these taxpayers are first-time tax return filers, the IRS has no prior tax return filing information to determine if the taxpayers pre-qualify. Furthermore, even if these taxpayers could qualify, the IRS does not have an address on file to which to mail a TeleFile tax package. For TY 2001, approximately 3.7 million first-time tax return filers filed a Form 1040EZ and were not eligible to use the TeleFile system.

To enable first-time tax return filers to participate, the IRS could develop a process similar to that used by the State of Massachusetts' Department of Revenue (DOR). TIGTA Office of Audit discussions with personnel from the State of Massachusetts' DOR identified that they are able to allow first-time tax return filers to use their TeleFile system because they have the necessary data to independently verify the legitimacy of the taxpayer. The data used by the state for its independent verification is the wage information for individuals employed in the state of Massachusetts.

The IRS is in negotiations to obtain a database (New Hire Directory) compiled by the Department of Health and Human Services that contains the names, SSNs, addresses, and employers for newly hired individuals. If the IRS obtains access to the New Hire Directory, it may provide the IRS with the necessary information to validate the

Opportunities Exist to Expand the TeleFile Program

legitimacy of first-time tax return filers. Furthermore, for these individuals, the IRS could use self-selected electronic signatures in lieu of the CSN and leave TeleFile tax packages out for public distribution instead of mailing them to taxpayers.

Taxpayers who move subsequent to the IRS' mailing of a TeleFile tax package are not eligible to use the TeleFile system

The IRS does not have a process to allow taxpayers to change their addresses subsequent to the IRS' identifying the taxpayers as eligible to use the TeleFile system and mailing them a TeleFile tax package. As a result, taxpayers who the IRS determines are eligible, but who moved, are no longer eligible to use the TeleFile system. The IRS needs the taxpayers' current addresses so any tax refund checks and notices that indicate that there was a problem with their TeleFile tax returns can be mailed to them.

The IRS could offer taxpayers who move the ability to directly deposit their refunds and update their addresses with the IRS after the tax returns are filed using the TeleFile system. Furthermore, the IRS could implement a process similar to the one used by the State of Massachusetts' DOR. The same address system used to establish an address for first-time filers is used to record the taxpayer's new address.

The most recent study performed by the IRS' Research Function identified that, for TY 1999, approximately 2.2⁴ million taxpayers were sent a TeleFile tax package; however, because they had moved they were no longer eligible to participate in the TeleFile Program.

Two primary factors have contributed to IRS management's reluctance to expand the TeleFile Program since the 1997 Filing Season

These two factors are:

⁴ TY 1999 data are the most current data available from the IRS for the number of taxpayers who moved subsequent to receiving a TeleFile tax package because the IRS does not track this information. This estimate was based on an analysis performed by the IRS' Wage and Investment Division, Strategy and Finance, Office of Research, dated November 2001.

Opportunities Exist to Expand the TeleFile Program

- *Management's incorrect perception that the processing costs for TeleFile tax returns significantly exceed the processing costs for paper-filed and other e-filed tax returns.* This perception was accurate in the early years of the Program; however, with the reduction in telecommunications and other costs, the cost to process TeleFile tax returns is now the least expensive method of processing Forms 1040EZ (see Figure 3). Management's perception was based on an ETA Filing Season Strategic Plan, which used 1996 processing cost data. For TY 2001, TeleFile return costs have been further reduced to \$2.53.

Figure 3
Form 1040EZ Tax Return Processing Costs⁵

Fiscal Year	Electronically Filed (<i>e-filed</i>) Tax Return	Paper-Filed Tax Return	TeleFile Tax Return
2000	\$3.00	\$3.92	\$2.84

Source: IRS Cost Estimate Reference Guide and Office of ETA.

- *Management's perception that the use of a telephone to file tax returns is considered obsolete because of the widespread use of computers and the Internet.* However, a U.S. Department of Commerce report shows that nearly half of all taxpayers with incomes less than \$35,000 (many of whom are among the current TeleFile Program market segment) do not have access to the Internet.⁶

As a result of these two factors, IRS management has maintained the position to support the TeleFile Program in its current form rather than to expand the Program.

IRS' expansion of eligibility requirements would result in significant benefits

If the IRS were to develop processes to expand eligibility for the TeleFile Program to first-time tax return filers (3.7 million) and taxpayers who move subsequent to

⁵ The processing costs for both *e-filed* and paper-filed tax returns are conservative because hardware and maintenance costs are not included.

⁶ *A Nation On-Line: How Americans Are Expanding Their Use of the Internet*, dated February 2002.

Opportunities Exist to Expand the TeleFile Program

receiving a TeleFile tax package (2.2 million), significant benefits would be realized. Specifically, if these 5.9 million taxpayers are provided the option to use the TeleFile system and elect this option in lieu of filing a paper tax return, the benefits would include the following:

Reduction in Taxpayer Burden

Taxpayers who elect to use the TeleFile system can do so at no cost and have the assurance of having a more accurate tax return than one prepared on paper. Tax returns filed through the TeleFile system are subjected to the same data screening validations as tax returns filed through other *e-filing* methods. These data screening validations are designed to identify potential erroneous claims.⁷ If errors are identified as a result of data validation, the return will not be accepted for processing by the IRS. The taxpayer is then notified by letter of the error condition and informed that he or she must resubmit the tax return on paper or via another *e-file* method.

Furthermore, the preparation time for a TeleFile tax return is much faster than that for a paper tax return. The IRS estimates that it takes 1 hour and 43 minutes to prepare a TeleFile tax return (see Figure 4), whereas it takes the same taxpayer 3 hours and 43 minutes to prepare a paper Form 1040EZ tax return (see Figure 5). Therefore, it takes a taxpayer an extra 2 hours to prepare a paper Form 1040 EZ tax return as compared to using the TeleFile system to prepare their tax return. This time savings can translate into monetary savings of \$312.7 million.⁸

⁷ The primary difference between the TeleFile and *e-file* methods is the way in which the tax return data are input, i.e., telephone versus computer.

⁸ To calculate the dollar value of the taxpayers' time, we used the amount of \$26.50 per burden hour as established by the Office of Management and Budget for the value of tax return preparation time. For more details, see the Outcome Measures on page 14.

Opportunities Exist to Expand the TeleFile Program

Figure 4
**Estimated Time for Taxpayer to Use the TeleFile System
to Prepare Their Tax Return**

Recordkeeping	6 minutes
Learning about the tax law or tax record	26 minutes
Preparing the tax record	39 minutes
TeleFile phone call	10 minutes
Preparing Form 8855-V (TeleFile payment voucher if money is owed)	22 minutes
Total Time	1 hour & 43 minutes

Source: 2002 TeleFile Tax Record and Instructions-Disclosure, Privacy Act, and Paperwork Reduction Act Notice section.

Figure 5
**Estimated Time for Taxpayer to Prepare a
Paper Form 1040 EZ**

Recordkeeping	4 minutes
Learning about the tax law	1 hour & 40 minutes
Preparing the Form 1040EZ	1 hour & 39 minutes
Copying, assembling and sending the Form to the IRS	20 minutes
Total Time	3 hours & 43 minutes

Source: 2002 Form 1040 EZ Instructions, Disclosure, Privacy Act, and Paperwork Reduction Act Notice section.

Continued Growth in E-Filing

The IRS' goal is to have 80 percent of all tax returns *e-filed* by 2007. The TeleFile Program is another electronic method by which taxpayers can file their tax returns. IRS management indicated that use of the TeleFile system is considered a first step in getting taxpayers to *e-file*. If the IRS could expand the TeleFile Program, this would help the IRS meet its *e-filing* goal.

Opportunities Exist to Expand the TeleFile Program

Processing Costs Savings

The IRS could save over \$6.3 million⁹ in processing costs per year by converting these paper tax returns to the TeleFile Program. Over 5 years, savings in IRS processing costs could be in excess of \$31 million.

TIGTA discussions with the TeleFile Project Office responsible for the IRS' TeleFile telecommunications identified that the current TeleFile system could handle a 20 percent increase based on 2002 Filing Season data, if the IRS includes first-time tax return filers and taxpayers who have moved.

In addition, a research report¹⁰ developed by a contractor for the IRS has shown 99 percent of TeleFile system users were satisfied with the TeleFile system. Therefore, the TeleFile Program is an excellent way for the IRS to promote free *e-filing* to a segment of taxpayers who may be seeking an alternative to using the Internet.

Recommendation

1. To expand taxpayer eligibility to participate in the TeleFile Program, the Director, Electronic Tax Administration, should develop a strategy outlining steps to be taken to offer the TeleFile Program to those taxpayers who file Form 1040EZ and are currently ineligible to use the TeleFile system.

Management's Response: IRS management agreed with our recommendation and plans to establish a task force to look at opportunities for expanding TeleFile to include taxpayers who move and first-time filers.

⁹ The IRS saves approximately \$1.08 per tax return to process a TeleFile tax return instead of a paper tax return (see page 6). For more details, see the Outcome Measures on page 14.

¹⁰ *Findings From the 2002 Wave of E-file Taxpayer and Preparer Satisfaction Research*, dated April 2002.

Detailed Objective, Scope, and Methodology

The objective of this review was to determine if opportunities exist for the Internal Revenue Service (IRS) to expand its TeleFile Program. To accomplish this objective, we conducted the following tests:

- I. Identified the IRS' Short-Term/Long-Term Strategy for the TeleFile Program.
 - A. Reviewed IRS' files relating to the TeleFile Program.
 - B. Interviewed pertinent IRS managers and executives and identified the oversight responsibilities and any short-term/long-term strategy for the TeleFile Program.
- II. Identified current eligibility requirements for taxpayers who are permitted by the IRS to use the TeleFile system.
 - A. Determined current eligibility requirements by reviewing the IRS' computer program that is used to select taxpayers who will receive a TeleFile tax package.
 - B. Determined the requirements for using the TeleFile system by reviewing the IRS' TeleFile tax package and the IRS' Internet website.
 - C. Determined the capability of expanding the TeleFile system by contacting pertinent IRS personnel.
- III. Determined the cost effectiveness of processing TeleFile tax returns compared to paper-filed tax returns and other electronically filed (*e-filed*) tax returns.
 - A. Determined the number of TeleFile tax packages that were mailed to taxpayers in the last 5 years and the number of taxpayers who filed using the TeleFile system.
 1. Determined why any decreases occurred in TeleFile tax package mail-outs or TeleFile tax returns.
 2. Determined the reasonableness of the criteria used to select taxpayers who will receive a TeleFile tax package.
 - B. Obtained TeleFile Program statistics and compared the costs to the taxpayer and the IRS for the various tax return filing methods.
 1. Determined the cost to the IRS to process a TeleFile tax return.
 2. Determined the cost to the IRS to process a paper-filed tax return.
 3. Determined the cost to the IRS to process an *e-filed* return.

Opportunities Exist to Expand the TeleFile Program

- IV. Identified opportunities that may exist for the IRS to expand the TeleFile Program.
 - A. Reviewed prior IRS and contractor research project recommendations for the TeleFile Program.
 - B. Researched the IRS' options for including in the TeleFile Program first-time tax return filers and taxpayers who have moved.
 - 1. Contacted the Massachusetts Department of Revenue to determine how its TeleFile Program can include, as eligible for the Program, first-time tax return filers and taxpayers who have moved.
 - 2. Determined the status of the IRS' attempt to obtain the Department of Health and Human Services' New Hire Directory.
 - C. Analyzed an IRS extract containing 19.3 million taxpayers who filed a Tax Year 2001 United States Individual Income Tax Return (Form 1040EZ) to determine taxpayers to whom the IRS could promote the TeleFile Program.
 - D. Determined which criteria could be included in the TeleFile Program to increase the number of eligible taxpayers without drastically increasing the amount of data the taxpayer would need to enter over the telephone.
 - E. Calculated the additional number of taxpayers the TeleFile Program could include if the Program was expanded.
 - F. Determined the cost savings to the IRS if the additional taxpayers use the TeleFile Program instead of another tax filing method.

Major Contributors to This Report

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

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Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective action will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Funds Put to Better Use – Potential; an estimated \$31,860,000 over 5 years (see page 3).

Methodology Used to Measure the Reported Benefit:

Computation of processing cost savings if the Internal Revenue Service (IRS) expanded eligibility of the TeleFile Program to first-time tax return filers and taxpayers who move subsequent to receiving a TeleFile tax package and these taxpayers elect to use the TeleFile system in lieu of filing a paper tax return:

Total 5.9 million taxpayers

- ***3.7 Million First-Time Tax Return Filers*** (based on Tax Year (TY) 2001 data) are not eligible to use the TeleFile system.¹
- ***2.2 Million Taxpayers Who Move*** (based on TY 1999 data) are not eligible to use the TeleFile system.²

Methodology for Processing Cost Computation

- Each paper United States Individual Income Tax Return (Form 1040EZ) costs the IRS \$3.92 to process,³ while a TeleFile return costs the IRS \$2.84. The \$3.92 cost for a paper Form 1040EZ, less the \$2.84⁴ cost for a TeleFile tax return, is \$1.08.
- Potential cost savings if first-time tax return filers and taxpayers who move are able to use the TeleFile system is 5.9 million taxpayers (3.7 million + 2.2 million) x \$1.08 = \$6,372,000, which is an estimated \$31,860,000 over 5 years.

¹ Treasury Inspector General for Tax Administration analysis of IRS tax return data.

² Tax Year 1999 data are the most current data available from the IRS for the number of taxpayers who moved subsequent to receiving a TeleFile tax package because the IRS does not track this information. This estimate was based on an analysis performed by the IRS' Wage and Investment Division, Strategy and Finance, Office of Research, dated November 2001.

³ Source: IRS Cost Estimate Guide for Fiscal Year 2000, which is the most current costing information available.

⁴ Source: IRS Office of Electronic Tax Administration.

Opportunities Exist to Expand the TeleFile Program

Type and Value of Outcome Measure:

- Taxpayer Burden– Potential; \$312,700,000 per year (see page 3).

Methodology Used to Measure the Reported Benefit:

If a taxpayer moves or is a first-time tax return filer, he or she is not allowed to use the TeleFile system, which causes most taxpayers to either take more time to file a paper Form 1040EZ or pay to have a return electronically filed.

Total 5.9 million taxpayers

- ***3.7 Million First-Time Tax Return Filers*** (based on TY 2001 data) are not eligible to use the TeleFile system.
- ***2.2 Million Taxpayers Who Move*** (based on TY 1999 data) are not eligible to use the TeleFile system.

If the 5.9 million taxpayers elected to use the TeleFile system, a reduction in burden would result from faster tax return preparation time,⁵ a more accurate tax return, and no cost to the taxpayer.

Methodology for Cost Computation

- The 2002 TeleFile Tax Record and Instructions estimate that it takes a taxpayer 1 hour and 43 minutes to use TeleFile. The 2002 Form 1040EZ instructions estimate that it takes the same taxpayer 3 hours and 43 minutes to prepare a paper Form 1040EZ tax return. Therefore, it takes a taxpayer an extra 2 hours to prepare a paper Form 1040EZ tax return as compared to using the TeleFile system to prepare their tax return.
- To calculate the dollar value of the taxpayers' time, we used the amount of \$26.50 per burden hour as established by the Office of Management and Budget for the value of tax return preparation time.
- Potential taxpayer burden is 5.9 million taxpayers (3.7 million +2.2 million) x 2 (hrs) x \$26.50 = \$312,700,000.

⁵ The IRS estimates that it takes a taxpayer 1 hour and 43 minutes to prepare a TeleFile tax return (including the time to learn about the tax law, prepare the tax record, and make the telephone call), whereas it takes the same taxpayer 3 hours and 43 minutes to prepare a paper Form 1040EZ tax return.

Opportunities Exist to Expand the TeleFile Program

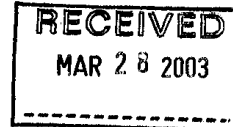
Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

March 27, 2003



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM:

John M. Dalrymple
John M. Dalrymple
Commissioner, Wage and Investment Division

SUBJECT:

Draft Report – Opportunities Exist to Expand the
TeleFile Program (Audit No. 200240061)

I reviewed your draft report and agree that opportunities exist to expand the TeleFile Program to two groups of ineligible filers. Taxpayers in these groups either move after receiving a TeleFile tax package, or are first time tax return filers.

Recently, we prepared a Request for Information Services for fiscal years 2004/2005 to allow taxpayers who move to use the TeleFile system if they choose to directly deposit their refund into a checking or savings account. We will update the taxpayer's address in our records after the tax return is TeleFiled.

In addition, the Submission Processing Vision Task Force is exploring the best use of ongoing investments for processing paper and electronic returns. As they develop a strategy, we will perform an analysis to determine the return on the investment if the money were spent on modernizing the e-file system rather than spending more dollars on legacy systems such as TeleFile. Electronic Tax Administration (ETA) will not begin any further analysis of TeleFile until the task force has completed its recommendations. ETA will take the action, as appropriate, after the recommendations from the task force are received and approved, and the cost benefit analysis is completed.

We disagree with the Outcome Measures as reflected in the draft report. The draft report provides cost comparisons in Appendix II that may not be consistent. The costing analyses compare dissimilar cost categories from separate sources. We acknowledge that cost information was provided to TIGTA by IRS; however, the bases for each category are different enough that conclusions should not be drawn from direct comparisons.

Opportunities Exist to Expand the TeleFile Program

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As ETA evaluates options and completes the cost benefit analysis for the TeleFile program, it will develop consistent cost comparisons that allow IRS to directly compare TeleFile costs per return with other filing methods.

Please also note that expanding eligibility for TeleFile would likely result in significant programming changes and corresponding investment and operational costs. These new costs are not reflected in the cost calculations in Appendix II of the draft report.

If you have any questions, please call me or Terry Lutes, Director, Electronic Tax Administration, at (202) 622-7990.

Attachment

Opportunities Exist to Expand the TeleFile Program

Attachment

Recommendation

To expand taxpayer eligibility to participate in the TeleFile Program, the Director, Electronic Tax Administration, should develop a strategy outlining steps to be taken to offer the TeleFile Program to those taxpayers who file Form 1040EZ and are currently ineligible to use the TeleFile program.

Assessment of Cause

Since the tax filing seasons of 1998 to 2000, the number of taxpayers who use TeleFile continues to decrease. We need to develop a strategy to include taxpayers who move and first-time tax return filers in the TeleFile program to increase the number taxpayers who participate in TeleFile.

Corrective Action

The Director, ETA will establish a task force to look at opportunities for expanding TeleFile to include taxpayers who move and first-time filers. The Task Force will be comprised of representatives from ETA, Wage and Investment Submission Processing, the Modernization Information and Technology Services TeleFile Project Office, Office of Refund Fraud, Small Business/Self-Employed E-Business Marketing Services, and Wage and Investment Individual Marketing Services.

Due Date

September 30, 2005

Monitoring Plan

As the options are developed, we will perform cost benefit analyses to determine which are feasible based on the return on investment. We will track Telefile use by the number of TeleFile users who moved and the number of TeleFile users who are first time tax return filers. We will also work closely with our Research Division to update data on all taxpayers who use TeleFile.

Responsible Officials

Director, Electronic Tax Administration
Director, Strategic Services, ETA